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Policy Option Evaluation

Milwaukee County Retirement Sustainability Taskforce

July 24, 2018

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Public Sector Retirement Systems Project

The Pew Charitable Trusts

- More than 40 active, evidence-based research projects
- Projects include public safety, immigration, elections, transportation, pensions, and state tax incentives
- All follow a common approach: data-driven, inclusive, and transparent

Pew's Public Sector Retirement Systems Project

- Research since 2007 includes 50-state trends on public pensions and retiree benefits relating to funding, investments, governance, and employee preferences
- Technical assistance for states and cities since 2011

Presentation Overview

- Review of Challenges Facing ERS
- Review of Scoring Different Policy Levers
- Review of Selected Policies
- Analysis of Example Reform Package
- Conclusion

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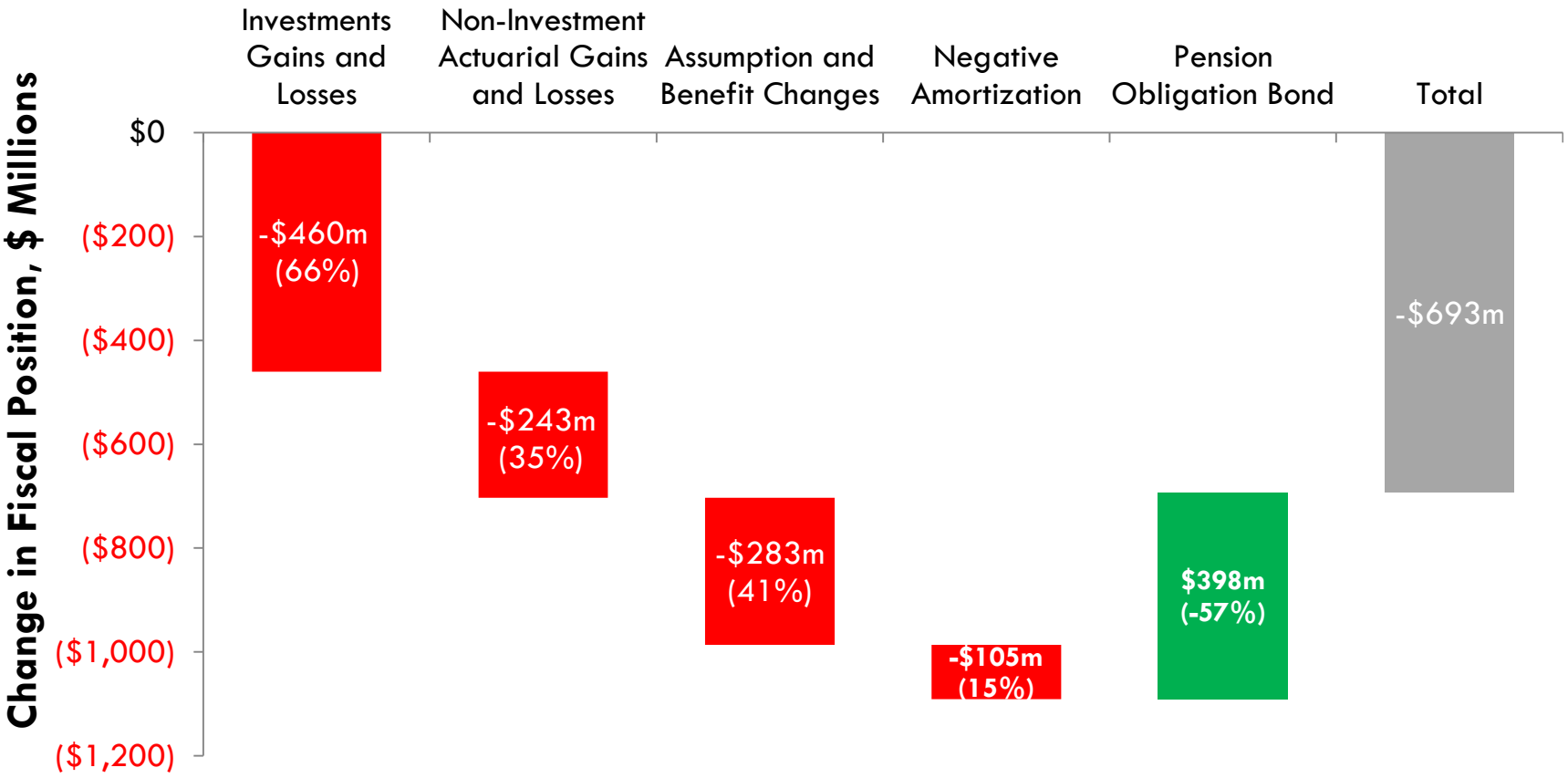
Review of Challenges Facing Milwaukee County ERS

Milwaukee County ERS Sources of Growth in Unfunded Liability (MVA), 2001-2016

ERS went from a $100 million surplus on a market value basis to a $585 million unfunded liability.



Notes:
Pew analysis using ERS actuarial valuations.

Findings from Reviewing of ERS and Policy Options

- A combination of investment risk and policy choices by the County led to a nearly $700 million swing from pension surplus to funding gap.
- New plan designs can reduce taxpayers' exposure to risk going forward. Changing the plan for new hires will not change existing liabilities.
- Closing the plan to new hires and transitioning to WRS or a DC plan can reduce the risk of future policy missteps.
- Most levers to address the unfunded liability change the timing of payments rather than addressing the underlying economics. Changing the rules for COLAs is an exception to that finding.

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Review of Scoring Different Policy Levers

Scores for New Plan Options

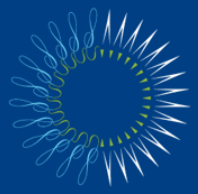
Criteria	ERS	WRS	DC, 1B	Risk-Managed Hybrid
1: Employer costs	3	3	3.5	3.5
2: Employee costs	3	2.75	2.75	3.25
3: Unfunded liability	3	3	3	3
4: Existing employee Retention	3	4	2.5	3.5
5: New employee recruitment	3	4	2.5	3.5
6: Risk	3	4	3	3.5
7: Future design flexibility	3	1	3	3
8: Ease of administration	3	5	4	2
9: Inter-generational equity	3	5	5	3
Average	3	3.53	3.25	3.14

Scores for Approaches to Managing The Existing Unfunded Liability

Criteria	Reduce COLA	Extend Amortization Period	Reduce Multiplier	Increase Employee Contribution Rate	Lower Discount Rate
1: Employer costs	5	4	4	4	2
2: Employee costs	5	4	4	1	2
3: Unfunded liability	5	2	3	3	4
4: Existing employee Retention	2	3	2	2	3
5: New employee recruitment	2	3	2	2	3
6: Risk	4	2	3	3	4
7: Future design flexibility	*N/A*	*N/A*	*N/A*	*N/A*	*N/A*
8: Ease of administration	2	3	2	3	3
9: Inter-generational equity	3	2	3	3	4
Average	3.5	2.88	2.88	2.63	3.13

Summary of Results from Scores

- The scoring exercise identified WRS as the highest rated new plan design though the other two options were also identified as improvements over current policy.
- Among the levers of managing the existing unfunded liability, only reducing the COLA and reducing the discount rate received positive scores.
- Submitted grades were largely consistent with the original scoring exercise.
- All of these scores weight all the criteria equally—the task force may choose to emphasize specific criteria in making deliberations.



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Review of Selected Policies

Milwaukee Has Tools To Provide Retirement Security to Workers in an Affordable and Sustainable Way

- Based on the scoring exercise as well as past taskforce discussions, there are policies that meet Milwaukee County's long-term goal to "ensure retirement security for future retirees and long-term fiscal sustainability for the County."
- Closing ERS to new hires and transitioning to WRS would stabilize costs over the long-term while providing county employees with a path to a secure retirement.
- Reducing and modifying the COLA would share the cost of addressing Milwaukee County's unfunded liability.
- Stress test analysis would allow county leaders and important stakeholders to track the fiscal health of ERS and ensure that costs and risks are manageable.

Plan Provisions: General Workers

	Milwaukee Co. Employees Retirement System (ERS) (Employees hired on or after August 1, 2011)	Wisconsin Retirement System (WRS)
Multiplier	1.6%	1.6%
COLA	2% simple COLA	Annuity adjustments are based on investment performance and other factors*
Employee Contribution (DB)	6.5%†	6.8%†
Vesting	5 years	5 years
Money purchase benefit	None	Yes, with 100% employer match‡
Normal Retirement	Age 64; 55 with 30 years of service	Age 65 & any years of service, or 57 & 30 years of service
Final Average Salary (FAS)	3 year average	3 year average
Social Security?	Yes	Yes
Risk-Sharing	Employees are required to contribute half of the gross normal cost and half of the amortization payment for the active employee share of the unfunded liability.	Employees contribute 50% of the total contribution rate. The annuity adjustment is based primarily on the investment returns of the plan's trust funds. Actuarial factors, such as mortality rates, also affect annuity adjustments.

Notes

† Rates for 2016; future rates based on actuarial analysis. Participants in ERS and WRS pay half of the normal cost and half of the active UAAL amortization.

‡ WRS calculates the retirement annuity using two methods: the formula method, which factors in years of service, age, salary and a benefit multiplier; and a separate money purchase method, which is calculated by multiplying a member's total employee contributions, an equal amount of employer contributions, and accrued interest by an actuarial factor based age and benefit effective date. Retirees receive whichever produces the higher amount.

Plan Provisions: Public Safety Workers

	ERS (Deputy sheriffs hired after January 1, 1994)	WRS (Protective Occupation Employees)
Multiplier	1.5 - 2.5%*	2.0 - 2.5%*
COLA	2.0%	Annuity adjustments are based on investment performance and other factors**
Employee Contribution (DB)	6.5 to 7.4%†	6.8%†
Vesting	10 years, or age 57	If you first began WRS employment on or after July 1, 2011, 5 years. Prior, vested at date of employment.
Money purchase benefit	None	Yes, with 100% employer match‡
Normal Retirement	Age 57 or age 55 with 15 years of service;	Age 54 with <25 years of service; Age 53 with 25+ years of service
Final Average Salary (FAS)	5 year average	3 year average
Participates in Social Security?	Yes	Yes***
Risk-Sharing	Employees are required to contribute half of the gross normal cost and half of the amortization payment for the active employee share of the unfunded liability.	Employees contribute 50% of the total contribution rate. The annuity adjustment is based primarily on the investment returns of the plan's trust funds. Actuarial factors, such as mortality rates, also affect annuity adjustments.

Notes

*For ERS, depends on bargaining agreement and date of hire, max benefit of 80% salary. For WRS varies based on hire date/participation in Social Security.

† Rates for 2016; future rates based on actuarial analysis. Participants in ERS and WRS pay half of the normal cost and half of the active UAAL amortization

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***Some firefighters under protective occupation hired/rehired after March 31, 1986 do not participate in social security.

Options for Modifying COLAs

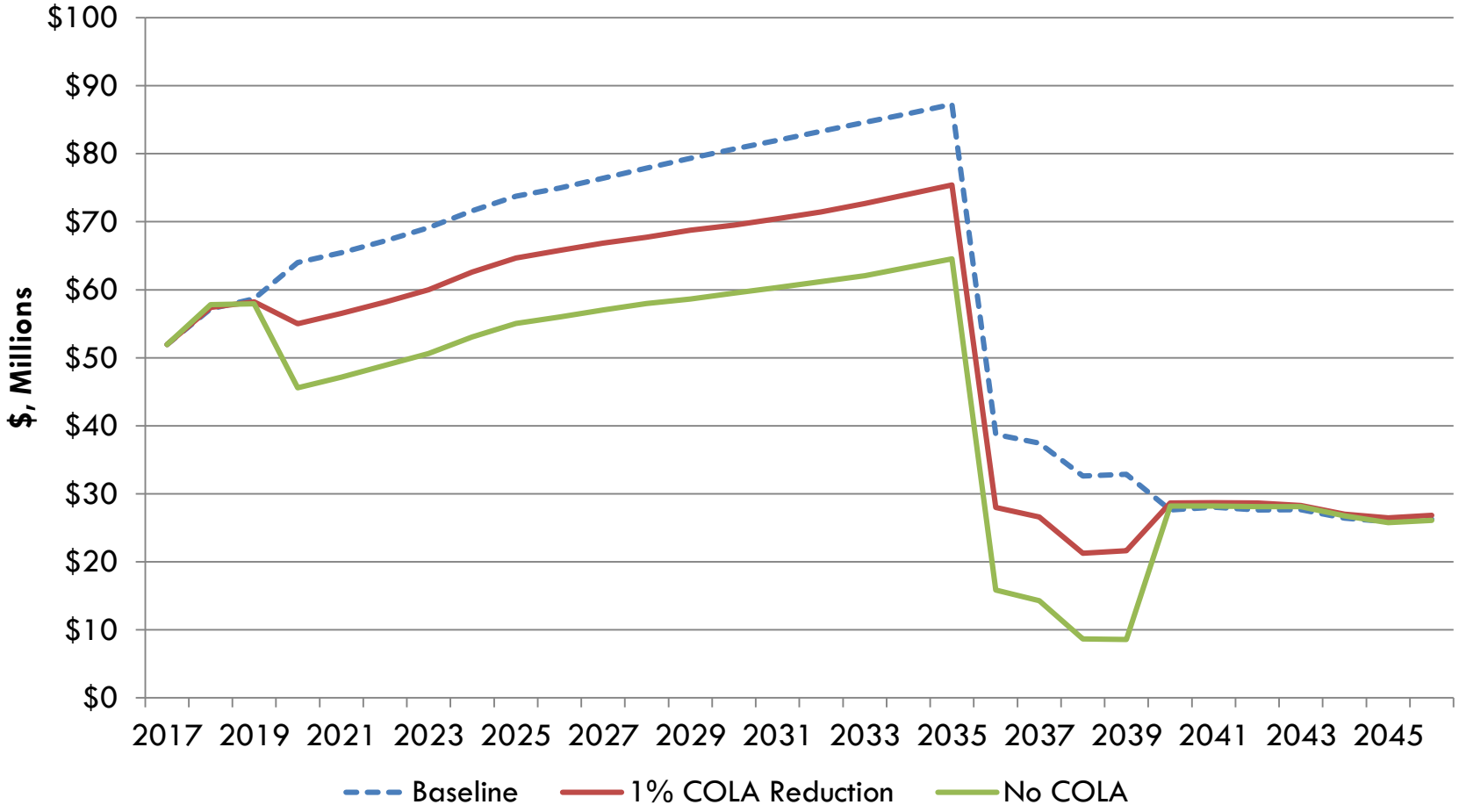
- Since the Great Recession, over 20 states have reduced or modified COLAs for current employees or retirees. At least seven have done so for future hires only.

- Policymakers have looked at this tool because it is one of the few available levers to reduce liabilities already on the books and thus experience near-term savings.

- Milwaukee County has already made prospective changes to current employees to bring benefits in line with what are available to new hires.

- Rather than a flat reduction, one option would be to mimic for ERS participants the WRS COLA provisions, which fluctuate based on plan funding levels and investment performance.

Projected Employer Contributions, Reducing COLA



Notes:
Actuarial projections done by The Terry Group based on Milwaukee County ERS plan assumptions. Updated using additional data from Segal.

Stress Test Reporting

- Regardless of which policy option that Milwaukee County chooses to adopt, they will continue to be managing ERS for decades to come.

- Understanding the fiscal position of ERS, changes to the financial health of that plan, and the riskiness of existing policies will help improve policymaking in Milwaukee County

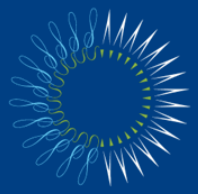
- Stress testing is a tool that would help accomplish that; we recommend that it be included in the regular actuarial analysis produced for ERS and included in the financial disclosures made available to policymakers, stakeholders, and the public.

- This is made more important if ERS is frozen as policymakers would need to pay extra attention to monitoring solvency risk and cash flow.

Core Components of Stress Testing

- **Long-term projections of key data points**: To understand the impact of current policy, and potential alternative policy options, long-term projections showing the trend of assets, liabilities, funded levels, benefit payments, normal cost, employer payments, and employee contributions is necessary.

- **Alternative assumptions:** Projections should be done under core plan assumptions as well as alternative assumptions—particularly looking at investment assumptions but including behavioral assumptions, demographic assumptions, and budgetary assumptions when practical.
  - Scenario Analysis: Stress testing can model specific economic scenarios, such as seeing how policies would react to the Great Recession and its aftermath. This can help policymakers plan for the next downturn.
  - Simulation Analysis: Also called stochastic analysis, this entails running many simulations where annual returns vary based on capital market assumptions. Shows the volatility of pension plan investments and the impact on employer contributions and plan balance sheets.



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Example Reform Package

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- We wanted to model the long-term fiscal impact of a package of changes that reflect both the proposed change to WRS as well as the potential reductions in the COLA.

- Given one concern with closing ERS is that employees remaining in the existing system could have excessive employee contribution rates, we also modeled capping the contribution rate at 9%.

- Finally, some of the existing discussions have suggested lowering the discount rate so we included a reduction in the return assumption to 7%.

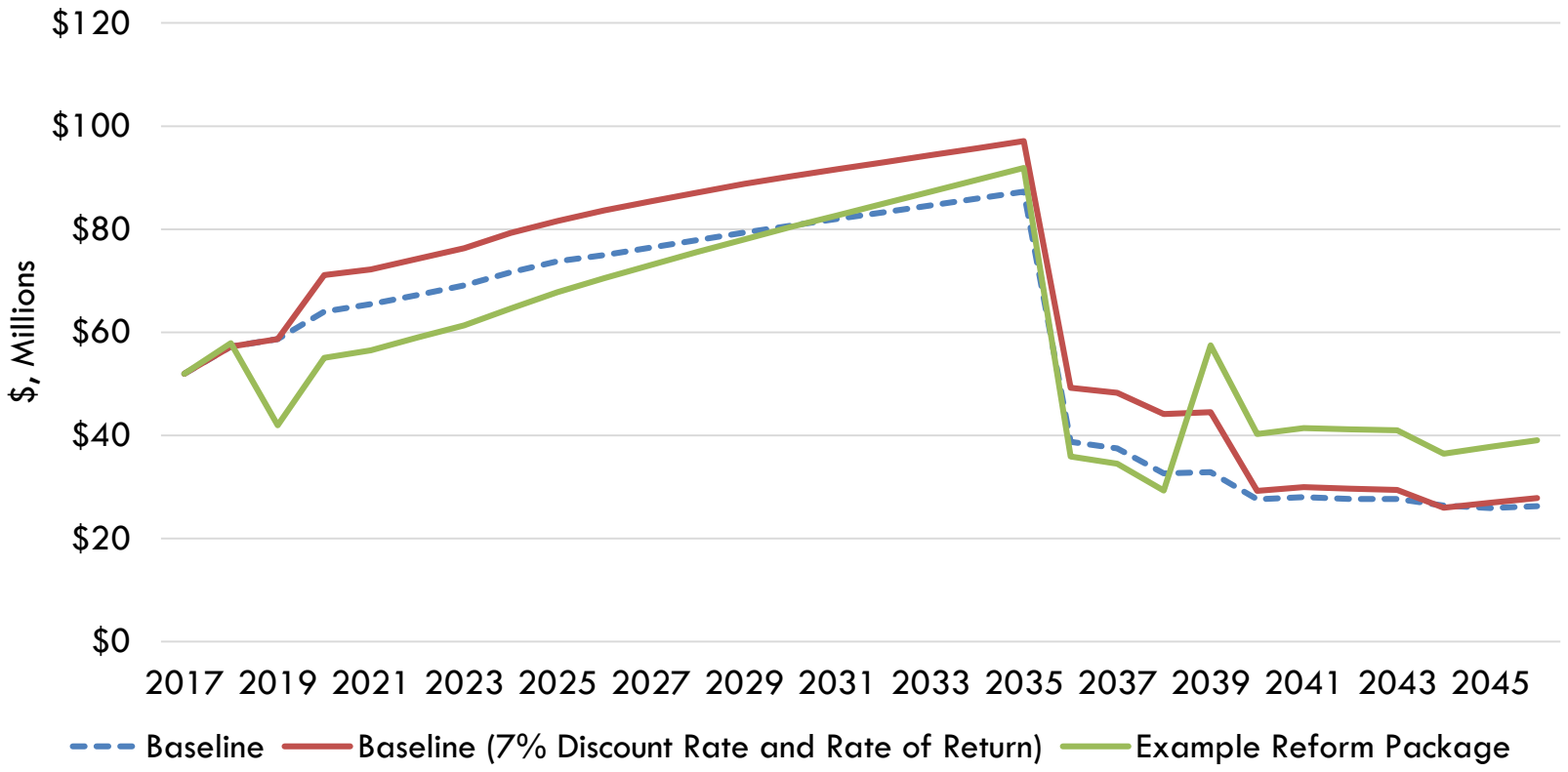
Reform Summary Results, 2017-2046

$Millions	Current Trajectory	If 7% Discount Rate and Rate of Return starting in 2020	Soft Freeze to WRS		
				9% Employee Cap	
					ERS 7% Discount Rate and Rate of Return in 2020
	Baseline	Baseline	2% COLA Reduction	2% COLA Reduction	2% COLA Reduction
Employer Costs	$1,723	$1,915	$1,541	$1,577	$1,764
Employee Costs	$698	$780	$697	$673	$689
Total	$2,421	$2,695	$2,238	$2,250	$2,453

Notes
Parts might not total due to rounding.
A soft freeze assumes all new employees enter the new retirement system while current employees remain in ERS.

Comparing Costs Over Time: Baseline and Reform Package

Employer Costs



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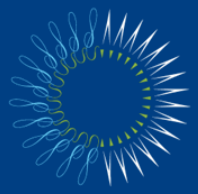

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Conclusion

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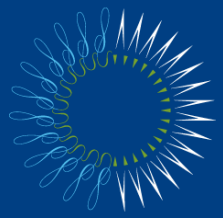
- Our review of Milwaukee County's pension funding challenges showed how a combination of investment risk and policy choices has left the County with about six hundred million dollars of pension debt.

- Through our work with the taskforce, we've examined a number of plan designs and other policy levers that could potentially help reduce the risk of repeating this scenario.

- Ultimately fiscal discipline combined with good policy choices and monitoring ERS' financial situation using stress testing will be needed to make whatever reforms the taskforce chooses work.

- We look forward to further helping analyze the final recommendations of the taskforce and continuing to answer questions and sharing our research.



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